

CANADIAN INSOLVENCY LEGISLATION RUSHES THROUGH HOUSE OF COMMONS

By: Steven G Golick, National Chair, Insolvency & Restructuring Group, Osler Hoskin Harcourt LLP

and: Robin B Schwill, Partner, Insolvency & Restructuring Group, Osler Hoskin Harcourt LLP

The Canadian House of Commons has passed a bill (Bill C-55) that contains comprehensive amendments to Canada's two major insolvency statutes, the Bankruptcy and Insolvency Act, and the Companies Creditors Arrangement Act.

This has been a very fast process by Canadian legislative standards. The reason for this is that it is expected that there will be a vote of non confidence which will have the support of the majority of the members of the House of Commons next week (the Liberal Party has a minority of seats in the House of Commons). All of the major political parties are cooperating to get the bill passed before the government falls and an election is called. This is mainly due to fact that the bill contains provisions creating a wage earner protection plan in insolvencies, which is a sensitive political issue.

However, there are other broad reaching amendments in the bill in diverse areas including wage earner protection, collective bargaining agreements, wage claims priority, pension claims priority, national receivers, executory contracts, licences of intellectual property, assignment of contracts, DIP financing, sale of assets, monitors, corporate governance, administrative charges, equity interests, as well as provisions similar to the recent Ch 15 amendments in the US. The following is a brief overview of some the highlights of some of these amendments.

Wage Earner Protection Program ("WEPP")

An employee whose employment is terminated and is owed wages which were earned during the six months immediately prior to a bankruptcy or receivership will be entitled to file a claim with the federal government for compensation towards such outstanding amount to a maximum of \$3,000 less ordinary payroll deductions. If a WEPP payment is made, the federal government is subrogated to any rights of the employee (to the extent of the amount of the payment) against the bankrupt or insolvent employer or any of their directors. WEPP payments cannot be assigned or pledged as security. The term "wages" includes the broad phrase "compensation for service rendered" which would include vacation pay entitlements but not termination and severance pay amounts which arise purely as a result of the termination of the employee's employment. What constitutes a "termination" for the purposes of the WEPP will be defined in the regulations and remains to be determined. Employees who are employed for less than or equal to three months or who were an officer or director of the employer, had a "controlling interest" in the employer's business, or occupied a "managerial position" are not entitled to receive a WEPP payment.

Collective Agreements

It will not be possible to disclaim or assign a collective bargaining agreement ("CBA") in the context of BIA proposal or CCAA restructuring proceedings and the CBA shall explicitly continue in force. If the insolvent employer cannot obtain the union's agreement to amend the CBA, then the insolvent employer can apply on 5 day's notice to the court for permission to give a notice to bargain to the union. If the parties agree to amend the collective agreement, then the union will have an unsecured claim for an amount equal to the value of the concessions granted by the union. The court will issue the order allowing a "notice to bargain" to be given to the union only if the court is satisfied that: (i) changes to the CBA are necessary to make a viable proposal; (ii) good faith efforts to renegotiate have been made; and (iii) the failure to issue the order is likely to result in irreparable harm to the insolvent employer. The legislation is silent as to the effect of the bargaining not resulting in amendments to the CBA acceptable to the union and the employer.

Priority of Wage Claims

An employee's claim for unpaid wages, salaries, commissions or "compensation" for services rendered during the six months immediately before the bankruptcy or receivership is secured to a maximum of \$2,000 on the current assets of the bankrupt or insolvent employer on that date (and an additional \$1,000 maximum for the disbursements of a travelling salesperson). If a trustee or receiver disposes of current assets covered by the secured claim, the trustee or receiver is liable for the claim to the extent of the amount realized on the disposition and is subrogated in and to all rights of the employee in respect of the amounts paid to that person by the trustee or receiver. A court cannot sanction a CCAA plan of arrangement or compromise unless such a plan provides for the payment to the employees and former employees of no less than the amount so secured. This secured claim ranks above every other claim, right, charge or security against the debtor's current assets, regardless of when that other claim right, charge or security arose, but does not rank ahead of the 30-day goods rights of suppliers and the special priority rights afforded to farmers/fishermen/aquaculturists.

Pension Plan Priorities

Amounts in respect of employee contributions collected but not remitted and regular required employer contributions due but not paid will now be a secured claim over all of the assets of a bankrupt or insolvent person in BIA receivership or proposal proceedings. A court cannot sanction a CCAA plan of arrangement or compromise or a BIA proposal unless such a plan or proposal provides for the payment of such secured amounts or there is an agreement with the relevant pension plan regulator as to the payment of such secured amounts. Special payment obligations regarding past solvency or going concern deficiencies and any existing pension plan deficit amount are not included in the amounts to be given secured status. This secured claim ranks above every other claim, right, charge or security against the debtor's current assets, regardless of when that other claim right, charge or security arose, but does not rank ahead of: (i) the 30-day goods rights of suppliers; (ii) the special priority rights afforded to farmers/fishermen/aquaculturists; (iii) source deduction deemed trust amounts; and (iv) the wage claim security referred to above.

National Receivers

A secured creditor will be entitled to apply to the court for the appointment of a person to act as a receiver to take possession and control of all or substantially all of the inventory, the accounts receivable or the other property of an insolvent person or a bankrupt that was acquired for, or is used in relation to, a business carried on by the insolvent person or bankrupt. Receivers will be required to be licensed trustees. The original concept of interim receivers under the BIA has now been limited so that the appointment of an interim receiver is specifically limited in time and the previous jurisdiction afforded courts to provide that an interim receiver may "take such other action as the court considers advisable" has been repealed. The repeal of the broad scope of powers originally afforded interim receivers has not been transferred to the national receiver concept and such powers appear to be limited to taking possession and control.

Executory Contracts

Specific authority will be afforded to debtors under either a BIA proposal or CCAA restructuring proceeding to be able to disclaim any agreement to which the debtor was a party on the date such proceedings were commenced (other than an eligible financial contracts, commercial real property leases, collective agreements and financing agreements under which the debtor is the borrower) provided that 30 days notice has been given to the other contracting parties. The treatment of eligible financial contracts, commercial real property leases where the debtor is the tenant and collective agreements are all dealt with separately with no material amendments being made to the rules already governing eligible financial contracts and commercial real property leases. A contracting party may object to the disclaimer but a court may not prevent the disclaimer if the court is satisfied that a viable proposal or plan could not be made without the disclaimer of the agreement and all other agreements that the debtor has disclaimed. If an agreement is disclaimed, every other party to the agreement is deemed to have a claim for damages as an unsecured creditor.

Intellectual Property Licences

While a debtor who is a licensor may disclaim such licences, the disclaimer does not affect the licensee's right to use the intellectual property so long as the licensee continues to perform its obligations in relation to the use of the intellectual property.

Assignments of Contracts

On application to the court with notice to all parties to the agreement, an insolvent person or trustee will be entitled to seek an order assigning the rights and obligations of the insolvent person under any agreement (other than an eligible financial contract, commercial real property lease (in a BIA proceeding only) where the debtor is the tenant, collective agreement, and

agreements which are not assignable by reason of their nature) to any person who has agreed to the assignment. In deciding whether or not to grant such an order, the court must consider whether the assignee would be able to perform the obligations and whether it would be appropriate to assign the rights and obligations to that person. If the assignment is being made in the context of a BIA proposal, then the court must also consider whether the insolvent person would not be able to make a viable proposal without the assignment. The court may not make the assignment under a BIA proceeding if the court is satisfied that the insolvent person is in default under the agreement and may not make the assignment under a CCAA proceeding unless the court is satisfied that all financial defaults in relation to the agreement will be remedied.

DIP Financing

Bill c-55 provides statutory authority for the court ordered granting of security over the insolvent person's property in connection with debtor in possession ("DIP") financing, which security would rank in priority over the claims of any existing secured creditors of the debtor. Only the debtor may bring an application for an order authorizing DIP financing. The court must have regard to the debtor's cash flow statement in determining the amount of financing to approve. If obtained on the initial order without notice, the DIP financing and corresponding court ordered charge will only be effective for the initial 30-day stay period. For DIP financing and the corresponding charge to be effective for longer than this initial 30-day period, the order must be sought after the initial application and on notice to all secured creditors likely to be affected by the security or charge. In deciding whether to make the order, the court must consider: (i) the period the debtor is expected to be subject to the restructuring proceedings; (ii) how the debtor's business and financial affairs are to be governed during the proceeding; (iii) whether the debtor's management has the confidence of its major creditors; (iv) whether the loan agreement will enhance the prospects of a viable restructuring; (v) the nature and value of the debtor's property; and (vi) whether any creditor will be materially prejudiced as a result of the debtor's continued operations.

Asset Sales

An insolvent person may not sell or otherwise dispose of assets outside of the ordinary course of business unless authorized to do so by a court. Bill c-55 provides that an application for sale approval must be made on notice to all secured creditors who are likely to be affected by the proposed sale or disposal. In considering whether to grant the order, the court must consider: (i) whether the sale process was reasonable in the circumstances; (ii) whether the trustee or monitor, as applicable, approved the sale process; (iii) whether the trustee or monitor, as applicable, has filed a report stating that that sale, if under a BIA proceeding, is necessary for a viable proposal that will provide a better result for creditors than if the assets were sold under a bankruptcy or, if under a CCAA proceeding, would be more beneficial to the creditors than if the sale took place under the BIA; (iv) the extent to which the creditors were consulted; (v) the effect of the proposed sale on creditors or other interested parties; and (vi) whether the consideration to be received is reasonable and fair, taking into account the market value of the assets. If the proposed sale is to a related party, the court may approve the sale only if the court is also satisfied that good faith efforts were made to sell to an arms' length party and the consideration

to be received is superior to that which would be received under all other offers actually received. In approving a sale, the court may also order that the assets be sold free and clear of any security, charge or other restriction provided that it also orders that the proceeds of realization shall be subject to a security, charge or other restriction in favour of the creditors whose security, charges or restrictions was so affected.

Monitors

Monitors under CCAA proceedings will be required to be licensed trustees and, except with the permission of the court, may not be appointed if, within the preceding two years, the monitor was: (i) the auditor, accountant or legal counsel of the company or a partner thereof; (ii) a director, officer or employee of the company; or (iii) related to the company or to any officer or director of the company. A monitor may not be appointed at all if it is already the trustee under a trust indenture or related to the trust indenture trustee. Duties of the monitor have been specifically codified and include: (i) publication of notice of the initial order once a week for two consecutive weeks; (ii) sending a copy of the initial order to the creditors and making a list showing the names and addresses of those creditors; (iii) determine with reasonable accuracy the state of the company's business and financial affairs and cause of its insolvency and file a report with the court thereon; (iv) file a report with the court on the state of the company's business and financial affairs after ascertaining any material adverse change in the projected cash flows or financial circumstances; (v) advise the court if it is of the opinion that it would be more beneficial to the company's creditors if proceedings were taken under the BIA; and (vi) make publicly available all documents filed with the court and all court decisions.

Corporate Governance

The court will be entitled, on the application of any person interested in the matter, to make an order removing any director of an insolvent company under BIA proposal or CCAA restructuring proceedings if the court is satisfied that the director is unreasonably impairing or is likely to unreasonably impair the possibility of a viable proposal or plan being made or is likely to act inappropriately as a director in the circumstances. The court may also fill any vacancy created by ordering the removal of any director.

On application of the debtor company, the court may make an order declaring that the property of the company is subject to a security or charge, in an amount that the court considers appropriate, in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that he or she may incur as a director or officer after the commencement of BIA proposal or CCAA restructuring proceedings. The court may specify that the security or charge ranks in priority over the claim of any existing secured creditor of the debtor. The court shall not make such an order if, in its opinion, the debtor company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

Administrative Charge

The court may make an order declaring that property of the debtor company is subject to a security or charge, in an amount that it considers appropriate, in respect of: (i) the costs of the monitor and any financial, legal or other experts engaged by the monitor in the course of the monitor's duties; (ii) the remuneration and expenses of any financial, legal or other experts engaged by the debtor; and (iii) the costs of any interested party in relation to the remuneration and expenses of any financial, legal or other experts engaged by it if the court is satisfied that the incurring of such costs is necessary for the effective participation of such interested party in the proceedings.

Equity Interests

Under a BIA proceeding, a creditor is not entitled to claim a dividend in respect of a claim arising from the rescission of a purchase or sale of a share or unit of the bankrupt, or in respect of a claim for damages arising from the purchase or sale of a share or unit of the bankrupt, until all claims of the other creditors have been satisfied. In a CCAA proceeding, creditors having a claim arising from the rescission of a purchase or sale of a share or unit of the debtor, or in respect of a claim for damages arising from the purchase or sale of a share or unit of the debtor must be in the same class of creditors in relation to those claims and may not, as members of that class, vote at the creditors' meeting called to vote on the plan or arrangement or compromise.

Cross-Border Insolvencies

The more expansive approach based on the Model Law on Cross-Border Insolvencies drafted by UNCITRAL, and akin to the new U.S. Chapter 15 provisions, has now been adopted into both the BIA and CCAA. Under these provisions, a foreign representative may apply to the court for recognition of a foreign proceeding on a streamlined evidentiary basis involving largely the submission of certified copies of orders or instruments creating the foreign proceeding and defining the authority of the foreign representative.

In granting the recognition order, the court shall specify whether the foreign proceeding is a foreign main proceeding or a foreign non-main proceeding. While any recognition order must be consistent with any order that may be made under the BIA or CCAA, as applicable, on the making of a recognition order of a foreign proceeding that is specified to be a foreign main proceeding, the court must (unless proceedings under the BIA or CCAA, as applicable, have already been commenced at the time the application for the recognition order is made) make an order, subject to any terms and conditions it considers appropriate, staying all proceedings against the debtor and prohibiting the debtor from selling or otherwise disposing of any of its property in Canada outside the ordinary course of business. When a recognition order is made in respect of a foreign non-main proceeding, if the court is satisfied that it is necessary for the protection of the debtor company's property or other interest of a creditor or creditors, the court may make any order that it considers appropriate, including an order staying all proceedings against the debtor, prohibiting the debtor from selling or otherwise disposing of any of its

property in Canada outside the ordinary course of business, and authorizing the foreign representative to monitor the debtor's business and financial affairs in Canada.

These provisions define "foreign court" as a judicial or other authority competent to control or supervise a foreign proceeding. A "foreign main proceeding" means a foreign proceeding in a jurisdiction where the debtor company has the centre of its main interests. In absence of proof to the contrary, a debtor company's registered office is deemed to be the centre of its main interests. A "foreign non-main proceeding" means a foreign proceeding other than a foreign main proceeding. And a "foreign proceeding" means a judicial or an administrative proceeding, including an interim proceeding, in a jurisdiction outside Canada dealing with creditors' collective interests generally under any law relating to bankruptcy or insolvency in which a debtor company's business and financial affairs are subject to control or supervision by a foreign court for the purpose of reorganization or liquidation.

Status of Bill C-55

The bill passed third reading on Nov. 21, 2005 in the house of Commons with one amendment. It is expected that the bill will receive fast track Senate approval by the end of this week and Royal Assent by Monday Nov 28, 2005. Assuming the bill receives Royal Assent on Monday, the majority of the amendments will not become effective until a date to be set by the Governor in Council, which is predicted to be at least several months away, in order to permit time for the new required regulations to be drafted.

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Toronto, Canada.